

# NAVAL POSTGRADUATE SCHOOL

## Monterey, California



## THESIS

### SUPER 301 AND THE TRADE DEFICIT

by

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June 1999

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Submitted in partial fulfillment of the  
requirements for the degree of

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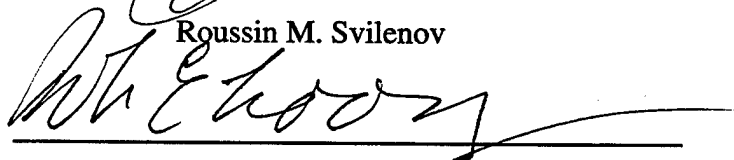
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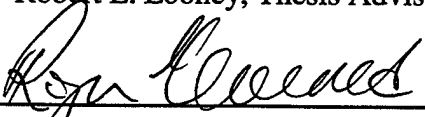
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## **ABSTRACT**

The thesis considers the issues associated with one of the amendments of section 301 of the Trade Act of 1974 - the so-called Super 301. It was included in the Omnibus Trade and Competitiveness Act of 1988. This measure was passed to solve problems with the U.S. bilateral trade deficits, which were considered to be a consequence of trade barriers to U.S. exports in foreign countries. Under Super 301 the United States presses foreign countries to eliminate unfair trade practices under threat of unilateral retaliation. The paper explores the history of Super 301, the cases of its application, the extent to which it achieved its purpose, and its implications for the international multilateral trade agreements. The paper concludes that the Super 301 has failed to eliminate the problem of the U.S. bilateral trade deficit with Japan, and has inspired resentment on the part of U.S. trading partners to negotiate under threat of punishment.

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## I. INTRODUCTION

In 1999, President Clinton re-instituted by an executive order the so-called Super 301 - a provision of the U.S. trade law that requires the United States Trade Representative to identify foreign countries' unfair trade practices whose elimination would lead an a increase of the U.S. exports. The main targets are countries with which the United States runs bilateral trade deficits. However, the use of this measure in the past has been associated with risks for the relations of the United States with its trading partners. Usually, the targeted countries consider Super 301 as a threat to the international trade system based on multilateral trade agreements.

The purpose of this paper is to examine the effectiveness of Super 301 since it was passed and draw conclusion about its future implications.

Super 301 is one of the amendments of section 301 of the Trade Act of 1974, which were included the Omnibus Trade and Competitiveness Act of 1988. The main reason for preparing and passing of this amendment was the intention of Congress to solve perceived problems with the huge bilateral trade deficits, which the United States was running in

1980s. These deficits were considered by many Congressmen to be a consequence of trade barriers to U.S. exports in foreign countries. Under super 301 the Administration has to identify "foreign country priority practices" whose elimination has the greatest potential for increasing U.S. exports. And, the elimination of these practices is accomplished under threat of unilateral retaliation on the part of the United States against a given foreign country, which is found to be unfair trader. The paper explores the circumstances under which super 301 was passed, the cases of its application, the problems associated with pressing foreign countries to open their markets under threat of punishment, the extent to which super 301 achieved its purpose, and its implications for the international multilateral trade agreements. The attention is focused mainly on some the U.S.-Japan disputes over trade imbalance and the alleged Japanese barriers to U.S. exports. The reason for this is that the U.S. trade deficit with Japan was the main argument for adopting super 301 in 1988. In the cases are presented the alleged offending trading practices, the expected benefits from their elimination, the reactions of the targeted countries, and the results achieved. The paper also discusses the possibility of eliminating bilateral trade imbalance by dealing with "unfair" trade

practices. At the end conclusions are made about the effectiveness of Super 301 and the implications of its use for the U.S. trade policy and the international trade system. The results of this study can also be useful in judging the effectiveness of the renewed Super 301 in pushing U.S. exports under unilateral threat of retaliation in the context of dispute settlement procedures of the World Trade Organization (WTO).

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## **II. BACKGROUND**

### **A. HISTORY OF THE SUPER 301**

According to the U.S. constitution, the Congress has the power to "regulate commerce" with foreign nations," including the authority to impose customs duties. The executive branch is given no specific authority over trade. It regulates trade only to the extent delegated by Congress. The delegation of authority to the administration was accomplished by the Reciprocal Trade Agreements Act of 1934. It empowered the President to lower tariffs by up to 50 percent through bilateral trade agreements in which the United States also received tariff concessions. The process of lowering the barriers to trade by reciprocal negotiations continued over several decades.

In 1988, Congress passed the Omnibus Trade and Competitiveness Act, with which it enhanced measures for opening foreign markets not necessarily on a reciprocal basis. Part of the content of this act were amendments of section 301 of the Trade Act of 1974. These amendments are the so-called "Special 301" and "Super 301." Special 301 provision was intended to help the administration to enforce

protection of intellectual property rights in foreign countries. The Super 301 provision was created as a means for opening of foreign markets where there was a significant potential for the business of American companies. The opening of markets was envisioned to be achieved under threat of denying import privileges or imposing of punishing import restrictions on the part of the United States. Thus, Congress forced the administration to be more aggressive in pushing U.S. exports. The increasing of exports was meant to solve the perceived problem with the trade deficit and competitiveness of American companies.

The amendment of section 301 in 1988 could be considered as the result of a process that had began in the early 1960s. With the emergence of the European Economic Community and its Common Agricultural Policy, Congress became concerned with barriers to U.S. exports that might not be addressed by the negotiations under the General Agreement on Tariffs and Trade (GATT). With the Trade Expansion Act of 1962, Congress for the first time authorized the president to retaliate against "unjustifiable, unreasonable or discriminatory" foreign countries' trade practices which "restrict or burden U.S. commerce"[1]. This authority was more discretionary for retaliation against "unjustifiable" foreign restrictions on

U.S. agricultural exports, and more limited for acting against barriers affecting other U.S. exports.

Section 301 of the Trade Act of 1974 expanded the president's authority to retaliate to foreign unfair trade practices by including all exports, plus services associated with trade. Under this statute private parties could petition the United States Trade Representative (USTR) to investigate the complaints about unfair trade barriers.

The Trade Agreements Act of 1979 amended section 301 by expanding the definition of services to include activities not directly associated with trade. It also established deadlines for the various phases of the investigations.

The Trade and Tariff Act of 1984 amended section 301 by broadening the definition of commerce to include foreign direct investments. The act also authorized the USTR to initiate investigations without waiting for a private petition or an order from the president. According to some political analysts, by authorizing USTR to initiate investigations, Congress intended to make the administration be more willing to invoke section 301 and more aggressive in prosecuting cases. In addition, the USTR was required to annually prepare a National Trade Estimate (NTE) of significant foreign trade barriers to U.S. commerce. The intention was to encourage the administration to set



specific trade negotiating priorities and to initiate section 301 investigations where appropriate.

In the 1980s Congress became increasingly concerned over the U.S. trade balance. The United States was running a huge trade deficit. This deficit was mainly the result of the domestic economic policy introduced in 1981 by the adoption of the so-called "Reaganomics." The reason for the deficit was the reductions in taxes and rising budget deficit complemented by tight monetary policy that produced an excess of national spending over production and an adequate supply of savings. In spite of the deficit the dollar continued to appreciate and many U.S. industrial and agriculture sectors were having difficulty in competing in the international markets.

In addition to domestic factors for it, however, many members of Congress thought that the trade deficit was also the result of restrictions that U.S. exports were facing in the markets of some the U.S. trading partners. And that due to these restrictions the relatively big U.S. bilateral trade merchandise deficits with these partners were considered as a problem with which Congress had to deal decisively.

The preparation of the Omnibus Trade and Competitiveness Act began in 1985. Its preliminary versions were passed in 1987, and it was signed into law in 1988.

In 1985 three influential democrats - Senate Finance Committee Chairman Lloyd Bentsen, House Ways and Means Committee Chairman Dan Rostenkowski, and Congressman Richard Gephardt - introduced a bill that would have imposed a 25 percent tariff increase on the imports from countries that were running "excessive" trade surpluses. The main targets were the imports from Japan.

In March 1986, the Ways and Means Committee passed the controversial so-called Gephardt's amendment. It would have required the USTR to identify countries with "excessive and unwarranted" bilateral trade surpluses and then to identify those that also engaged in a pattern of "unjustifiable, unreasonable, or discriminatory trade policies having a significant adverse effect on U.S. commerce" [1]. Then the USTR would have begun negotiations with targeted countries to resolve the problem with the trade deficit. These countries would have been expected to reduce their bilateral surpluses by at least 10 percent annually. If the target countries failed to negotiate reductions in their trade surpluses with the United States, they would have faced mandatory retaliation.

Some politicians, however, were concerned that this proposal was associated with some risks. Some U.S. trading partners would have found the unilaterally imposed goal for reducing the surplus unacceptable and would have refused to negotiate at all. And if United States raised its barriers in retaliation, U.S. consumers would have paid the price. And, if foreigners also retaliated by increasing the barriers to U.S. exports, then all parties would have been worse off. If the Gephardt formula was applied to Japan in 1989, it would have required almost \$15 billion reduction in Japan's bilateral surplus over a period of three years. In his statement in the Senate on June 25, 1987, Senator Danforth said:

The Gephardt's approach implies that America can no longer compete in the international markets and that the only way to reduce our trade deficit is to erect barriers and shut ourselves off from the world. This approach would violate our GATT obligations, thereby inviting retaliation from our trading partners. It uses trade retaliation to deal with portions of our trade deficit that have nothing to do with unfair foreign trade practices. Ultimately it offers not fair trade but less trade [2].

The Gephardt's amendment did not gain the necessary support in Congress. The latter finally passed super 301 as an alternative. It provided greater latitude for the president in designating priority foreign countries and was associated with lower risks. As passed the super 301

required the president in 1989 and 1990 to designate trade negotiating priorities and priority countries practicing unfair trade. The retaliation under Super 301 was made discretionary in cases involving unreasonable or discriminatory barriers to U.S. commerce that did not violate a trade agreement. Some congressmen, however, were not satisfied with the discretion that the president had over retaliation. On June 8, 1988, Senator Levin said:

...I would prefer an approach to trade that treats our trading competitors no better than they treat us. This bill does not do that. It still allows the President not to act if he chooses and provides him with too many options for avoiding retaliation against the nations discriminating against our workers and our goods [3].

The measure Super 301, dealing with overseas discrimination against U.S. exports, was especially aimed at Japan, which at that time was running a huge trade surplus with the United States and was considered to be unfair trader for allegedly imposing barriers to U.S. exports. On April 22, 1988, Senator Riegle stated:

What is significant is if you look at bilateral trade deficits for 1987, you will see the bilateral deficit for Japan alone was over \$60 billion. That meant that Japan on net was taking \$60 billion out of the United States economy. That is \$5 billion a month. It is an extraordinary withdrawal of capital from a nation that needs capital and has a low savings rate. ...When you look at it, you will find that there are a whole set of reasons, including a lot of unfair

trade practices where the Japanese will not let American products come into Japan and be sold [4].

The rationale behind the statements of this kind was the notion that a bilateral trade deficit with a given foreign country proved that this country's market is relatively closed to U.S. exports compared with the "open" U.S. market. The new trade act was considered to be the tool for imposing fair trade. On February 16, 1988, Representative Gaydos stated:

Instead of allowing the Japanese and our other trading partners to continue taking over our market while we are barred from selling our goods in their country, we need to level our trade balance.

That's one of the main reasons my colleagues that I introduced H.R. 3, the omnibus trade bill.

The bill strengthens the authority of the U.S. trade representative to retaliate against the unfair trade practices of our trading partners and it will help identify nations which limit our access to their markets [5].

#### **B. SECTION 301 AS AMENDED**

Below are described the procedures prescribed by the regular section 301 and the Super 301.

Under Section 301 the United States may decide to impose trade sanctions on foreign countries that maintain an act, policy, or practice that is unjustifiable, unreasonable or discriminatory and restricts U.S. commerce. The United

States also may attack a foreign country's act, policy or practice that violates or denies U.S. rights or benefits under trade agreements. An act, policy, or practice is defined as unreasonable if it is inequitable and unfair, even if it does not violate the U.S. international legal rights. Under this definition the USTR can target a country because of a practice of denial of fair and equitable opportunities for the establishment of enterprises, or lack of an adequate and effective protection of intellectual property rights. This applies even when the country is in compliance with the WTO Agreement on Trade-Related Aspects of Intellectual Property. A country can also be targeted for a toleration of systematic anti-competitive activities on the part of enterprises in that country, whose effect is restricted market access of U.S. goods or services.

Under the Super 301 the USTR is required to identify priority foreign country practices, whose elimination is likely to have the most significant potential to increase U.S. exports. In targeting a particular country the USTR has to take into consideration factors as: the barriers and trade distorting practices he sets out in the National Trade Estimates Report; the medium-term and long-term implications of the country's government procurement plans; and the

international competitive position and export potential of U.S. products and services.

Where USTR determines that a given act, policy or practice of a foreign country is unreasonable or discriminatory and burdens or restricts U.S. commerce, it has discretion as to whether to take retaliatory action. And where a retaliatory action is undertaken it must be equivalent in value to the burden or restrictions imposed on U.S. commerce by the foreign country.

The procedures, which the USTR is required to follow under the section 301, is assumed to provide an opportunity for the U.S. Government to seek ways of solving the foreign trade issues, before taking of retaliatory actions.

Retaliatory actions can include suspending or withdrawing from any trade agreement, imposing tariffs or quotas on foreign imports, or negotiating a new agreement to eliminate the offending policy. Petitions to the USTR for redress or retaliation may be filed by any interested party, including any representative of an industry or group of workers.

As described above, the United States can undertake two sorts of actions under section 301. First, actions that are taken to enforce the trading rights that United States has acquired under trade treaties (such as GATT) but which

impartial adjudicators have found to be "nullified and impaired" by a foreign nation. Second, actions that are taken to win entirely new rights, based on a unilateral finding of unfair practices, and under threat of retaliation which is often GATT-illegal in design (as when the United States threatens to raise tariffs which are bound under GATT).

The first category of actions does not create problems. The second sort of actions, however, creates the conditions for problems with the targeted countries. According to some critics, when the United States decides unilaterally that a foreign trading practice is unacceptable, and threatens to close its market - disregarding its own GATT commitments - the rule of law has been replaced by the law of the jungle [6]. When the United States uses Super 301 backed by its economic power, politics rather than markets governs trade, and power tends to be seized by domestic lobbies, which then use it to run American policy to their own advantage.



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### **III. APPLICATION OF SUPER 301**

#### **A. FIRST CASES**

According to the directions of Congress, on May 25, 1989, U.S. Trade Representative announced under Super 301 the first priority practices in three countries. These countries were Japan, Brazil and India. Japan was included in the list of USTR because of three priority practices: (1) exclusionary procurement policy affecting supercomputers; (2) exclusionary government policy affecting satellites; and (3) technical barriers to trade in forest products. Brazil was cited for restrictive import licensing system affecting agricultural and manufactured imports. India was targeted for barriers affecting foreign investment flows and entry into the insurance industry.

On the same date the President announced a separate Structural Impediments Initiative to address the alleged Japanese trade barriers. The negotiations with Japan were to take place outside the Super 301 framework. In spite of the pressure on the part of Congress, the Administration decided that issues with Japan should be addressed in a less confrontational forum.

Reportedly, Brazil and India were included in USTR's list of countries with priority practices in order for the United States to avoid citing only Japan, thereby softening the blow on the Japanese.

## **1. Japan**

In 1989, Japan was the second largest country market for U.S. exports. It was purchasing over 12 percent of the U.S. exports. However, the imports from Japan in the previous years had exceeded exports to it and as a result the United States was running huge trade deficit. And this trade deficit highlighted the concerns in the United States about the Japanese trade practices.

With respect to the supercomputers, the U.S. supercomputer industry claimed that it had been denied access to the Japanese public-funded market. U.S. producers had 80 percent share of the world supercomputer market and only a 6 percent share of Japan's government and publicly funded university market.

The U.S. producers complained that they were disadvantaged by two mechanisms. First, U.S. firms found themselves excluded from serious consideration in Japanese government procurement because technical specifications

avored Japanese suppliers. Second, the low Japanese government's supercomputer budgets caused the Japanese firms to make discounts of up to 80 percent off the list price. Under these conditions the benefits for the Japanese firms were: improving the possibility of replacement sales; training new users who would be future buyers; and feedback from sophisticated users on how to improve hardware or software [1].

To remedy this situation, the USTR proposed that the Government of Japan change technical specifications and increase the budgets of publicly funded customers.

In the case of satellites, the dispute was caused by Japan's policy to develop an autonomous satellite and launch service capability. This policy required maximum utilization of Japanese technology and equipment by Japanese government agencies and a ban on the purchase of complete satellites from foreign countries. All Japanese satellite procurement was channeled through the National Space Development Agency of Japan. This agency was choosing Japanese contractors to build satellites. And U.S. subcontractors were being chosen only to provide those technologies which the Japanese did not possess.

U.S. proponents of the case of satellites found it important to prevent Japanese from targeting of an important

high technology industry in which the United States had a strong competitive advantage. If the Japanese market was open, the U.S. satellite producers could have achieved significant economies of mass production.

The dispute over the wood products was caused by Japan's tariffs and tariff classification of wood and paper products as well as building codes and product standards that favored other non-wood construction materials. It was claimed by the U.S. National Forest Products Association that Japanese barriers cost the U.S. wood industry over \$1 billion annually in lost sales. In the previous years United States had pressed for liberalization of Japanese wood market through an agreement. But this liberalization was slowed because the Japanese government faced political resistance from its industry, which was in economic decline and strongly opposed further liberalization.

In its response to designation as unfair traders, the Japanese refused to accept U.S. allegations. They said that not Japan but the United States was unfair in acting unilaterally because the United States imposed a considerable number of trade restrictions itself. The Japan's government believed that the U.S. trade deficit problem was a consequence of U.S. macroeconomic policies and that there was little Japan could do. The U.S. super 301

action was viewed as an attempt to find a foreign scapegoat and to divert attention from the major causes of the U.S. trade deficit - the federal budget deficit, and low investment and savings.

The Japan's government refused to enter into negotiations in the context of Super 301 - under the threat of unilateral sanctions. Instead, it agreed to discuss the problems raised by the United States in another forum. Japanese also agreed to the Structural Impediments Initiative talks, but insisted that these talks should include American as well as Japanese impediments to trade.

Ultimately, through negotiations outside of Super 301 context, Japan offered minor concessions, mainly on supercomputers and satellites.

## **2. Brazil**

In 1989, Brazil was the 18<sup>th</sup> largest country market for U.S. exports. In the previous years the United States had run relatively small trade deficits with Brazil. In 1988, it was \$5 billion. The main source of U.S. problems were the Brazilian import barriers.

Brazil maintained an import prohibition list of approximately 1,000 items and used import licensing for

specific import quotas. This was viewed as an effective barrier to U.S. exports of agricultural products and some manufactured goods.

The Brazilian government protested against being targeted by the USTR. It argued that U.S. unilateral actions with threatened sanctions went contrary to the GATT multilateral commitments. Brazilians found U.S. trade complaints to be without justification, because Brazil was faced with economic stagnation, hyperinflation, deteriorating living standards, and a burden of \$115 billion foreign debt. And the Brazilians considered United States as highly protectionist country that was impeding Brazil's efforts to resolve its economic problems. In their opinion, the United States was pressing for market-opening concessions from foreign countries, but was unwilling to eliminate its own import restrictions. The U.S. budget deficit was considered to be at the heart of U.S. trade problems.

Brazilians argued that U.S. unilateral action with an implied threat of sanctions violated the multilateral mechanisms of the GATT. United States threatened to impose sanctions, whether or not the sanctions were consistent with its GATT commitments. Brazilian import restrictions were designated as barriers, even though the restrictions had

been justified as a temporary balance of payments measure under Article 18 of the GATT treaty, and had been approved by the GATT balance of payments Committee and the Council of Representatives, with United States concurring in both forums.

According to Brazilians, the mere designation of Brazil could prove harmful to Brazilian trade and investment, because of the uncertainty it created by placing exports under the threat of possible future retaliation. Brazil's representatives asserted that they could not accept bilateral consultations within the framework of U.S. law. They pledged to seek trade liberalization measures in the multilateral GATT framework where such efforts should be handled.

Brazilians argued that their restrictions were necessary to deal with their balance of payments difficulties and to service their foreign debt, with a significant portion of payment going to U.S. commercial banks. And the threatened sanctions were unwarranted because the country was moving toward trade liberalization and had undertaken steps, which substantially benefited the United States. This liberalization had resulted in an increase in the imports of U.S. products of 60 percent from



1983 to 1988. This rate was more than double the average growth of American exports worldwide.

### **3. India**

At the time of designation India was the 26<sup>th</sup> largest country market for U.S. exports. Since 1986, the Indian market had accounted for less than 1 percent of total U.S. exports.

The problem consisted of the practices and policies of Indian government that limited foreign investment and imposed various requirements on those U.S. companies that invested in India. Foreign investors generally could hold only 40 percent equity in around 30 so-called "core sectors." Investment outside these sectors was prohibited unless production was predominantly for export, used proportion of local materials and equipment, and incorporated advanced technology. The insurance companies were government-owned. Indian private sector as well as foreign insurance companies had no direct access to India's \$2.6 billion insurance market.

When the USTR targeted India, the Indian government and businesses reacted with criticism. Indian officials claimed that the United States was violating its own commitments

under the GATT by trying to impose its own trade terms through bilateral negotiations. India resented being put in the same class with Japan, whose trade surplus with the United States significantly exceeded India's.

Ultimately, India refused to negotiate on its barriers to insurance and foreign investment bilaterally and declined to make concessions. It was named again as a country with unfair practices in 1990. But the United States did not retaliate. Supposedly, because India would surely have taken the case to GATT, which likely would have ruled U.S. action as illegal [6].

In 1989, the USTR had intended to designate also Korea and Taiwan as priority countries. These countries offered concessions in advance in order to avoid targeting. Neither country, however, offered meaningful concessions on agriculture, which was the subject of most private-sector complaints submitted to USTR during the designation process. South Korea's major concessions were in the areas of investment and other administrative barriers raised by customs procedures and technical standard setting. But the implementation of these concessions was slow and became the subject of later negotiations.

According to some analysts, the concessions of Taiwan and Korea were facilitated by the fact that the two

countries were heavily dependent on the United States for their security. At that time these countries also were not proper democracies, and so did not need to worry about popular resentment.

#### **B. THE U.S.-JAPAN DISPUTE OVER AUTOS AND AUTO PARTS**

On March 3, 1994, the U.S. President signed an executive order to re-institute Super 301, which had expired in 1990. This event followed a failure of the negotiations with Japan on autos and auto parts. Japan had refused to accept U.S. demands for the establishment of "objective criteria" according to which the American penetration of markets in other industrialized countries would have been used as a standard for measuring access to Japanese market. Under the "United States-Japan Framework for a New Economic Partnership," signed on July 10, 1993, the U.S. government had insisted that Japan agree to enforceable "quantitative targets."

Japanese negotiators argued that numerical indicators of that kind would obligate the Japanese government to create quotas for American goods in the Japanese market. They stressed that such an obligation was against the

international free trade principles, and that the Japanese government did not have the necessary enforcement power.

The demands of the U.S. Government on Japan mainly involved three issues: (1) increased purchases of U.S. automobile parts by Japanese manufacturers, both in the United States and Japan; (2) a fixed number of new dealerships in Japan offering American autos; and (3) easing of some of Japan's restrictive inspection rules for critical auto parts. The pressure to attack Japan under Super 301 came from the U.S. auto-manufacturers, which complained about the difficulties they met in selling in Japan's market.

With regard to the re-instituting of Super 301 the Japanese government top spokesman said that Japan "hopes the U.S. will avoid steps that will create mutual distrust" [7].

According to the statement of the then USRT, Mickey Kantor, the administration's efforts with respect to Japan were to be directed toward more balanced trading relationship. In 1993, Japan's trade surplus with the United States was \$59.3 billion. Under the executive order that re-instituted Super 301 the USTR was to identify in 1994 and in 1995 those "priority country practices," whose elimination had the greatest potential for the expansion of U.S. exports. The identification was to occur on September

30, six months after the issuance of the NTE report on March 31.

Not all U.S. politicians, however, thought that the alleged Japanese trade barriers were the cause of the bilateral trade deficit. On March 22, 1994, Senator Bradley while criticizing Japan for the trade barriers said that the main reason for the trade deficit were the macroeconomic factors [8]. He stated that quantitative measures would not eliminate the bilateral trade deficit. A comprehensive study of the Institute for International Economics had concluded that Japanese market access barriers were limiting American merchandise exports by only about \$9 to \$18 billion, and this was less than the increase of that deficit since 1990. According to him, the economic fact was that the overall U.S. trade deficit would continue as long as the gap remained between American savings and investment. Japan, at that moment, was in recession while the U.S. economy was enjoying a recovery. And this combination of Japan in recession and United States in recovery had led to worsening of the bilateral trade deficit. And, a growing Japanese economy would do more than quantitative targets to bring the deficit down.

In spite of this, however, in the spring of 1995 again the argument of the U.S. bilateral trade deficit with Japan

was often used by many members of Congress in their calls to the Administration to undertake tough actions against Japan. On May 3, Congressman Meyers of Kansas stressed in his statement in Congress that as long as the automotive imbalance existed the United States would never be able to reduce its trade deficit with Japan. On May 9, 1995, Senator Byrd blamed Japan for protecting its auto market and thereby maintaining an anti-competitive environment for its manufacturers. Thus the latter were able to charge higher prices in Japan in order to subsidize their lower prices in the United States allowing them to be artificially more competitive. He said:

The devastating result of these practices in the automotive industry, for both new cars and parts, has been unacceptably high and persistent trade deficit with Japan. The result in 1995 was a ballooning trade deficit with Japan of \$66 billion, up 10 percent over 1994, of which \$37 billion, or 56 percent of the total is attributable to cars and auto parts, [9].

The last U.S.-Japan negotiations over autos collapsed on May 5, 1995. After months of negotiations the Japanese auto manufacturers were not going to make any specific quantitative commitments to increase their purchase of auto parts from non-Japanese firms. Also, the Japanese government was not going to make a quantitative commitment

to increase the number of auto dealers that sell and service foreign cars.

On May 16, 1995, the U.S. government announced that it would impose a 100 percent tariff on luxury car imports from Japan if no agreement was achieved till June 30, 1995. The imposition of tariffs was to begin four days later. There were 13 Japanese luxury models in 1994 with base price above about \$30,000. In terms of revenue, these models accounted for almost 40 percent of the value of imports. There were no Japanese cars with base prices in excess of \$30,000 produced in the United States. And the Japanese luxury cars were easy to target and a potentially effective group of products on which to impose a tariff.

Pressure on the part of Congress was based also on the argument that Japanese barriers to U.S. auto exports were causing problem with employment. On May 17, 1995, Representative Brown, of Ohio, stated:

When we have a \$25 billion trade deficit with the Japanese on auto-related, automobiles, and auto parts, ...it is literally hundreds of thousands of good paying industrial jobs in this country that have gone to Japan because their trade doors are closed to American goods [10].

In response to the threat of retaliation Japan announced that it would take the case to the World Trade Organization. The new multilateral trade rules adopted by

the Uruguay Round of the General Agreement on Tariffs and Trade came into force on January 1, 1995. The newly created WTO had a much stronger dispute settlement process. Establishing of this process was a top U.S. priority. In spite of the fact that the new rules did not preclude a country from taking unilateral actions, they required that grievances first be taken to the WTO. Furthermore, the rules forbade a country from unilaterally changing bound tariffs unless a WTO panel found the alleged offending nation guilty.

In its comments from June 1995 on the announcement of imposing of 100 percent punitive duties under Super 301, the Japan Automobile Manufacturers Association (JAMA) saw the following problems with the U.S. action [11]. JAMA argued that the imposition of punitive tariffs, in any amount, would violate U.S. obligations under the WTO Agreement. And it was the United States along with Japan and other nations, that straggled so hard and so long in the Uruguay Round negotiations to strengthen the new dispute resolution procedures and rules so that WTO members would not feel free to undertake protectionist actions without any real limits.

In terms of GATT law, the Japanese considered the proposed punitive duties as simply illegal. The unilateral retroactive imposition of punitive tariffs violated U.S.



obligations under Article 1 and 2 of the GATT, and Article 23 of the Dispute Settlement Understanding. Article 1 of GATT imposed an obligation on member countries to apply duties on a "Most Favored Nation" basis. The imposition of punitive duties against Japan alone violated this principle. Article 2 of the GATT required countries to abide by the schedule of bound tariffs negotiated under GATT. The imposition of 100 percent duties on Japanese automobiles violated this provision because the U.S. schedule of bound tariffs under Article 2 provided for maximum duties in the amount of 2.5 percent ad valorem. Article 23 of the WTO Agreement entitled "Understanding on Rules and Procedures Governing The Settlement of Disputes" required that trade disputes between signatories must be submitted to review. Only after such mandatory dispute resolution, and a determination by the WTO that there has been a violation, could one nation take legal retaliatory action against the trading partner that was in violation.

JAMA stated that the unilateral imposition of punitive duties threatened the entire WTO system. The basis for the proposed sanctions were Japan's domestic automobile safety inspection regulations. However, such regulations were not unique to Japan. In fact, all developed countries regulated automobile operations for the protection of public safety

and the environment. The Japanese considered this to be a domestic regulatory matter and not a trade issue. Thus, unilateral action in the form of 100 percent duties was seen as inappropriate in this context. And the U.S. position, if generally accepted and similarly pursued by other countries, would have completely undermined the GATT system. According to JAMA, any interpretation of GATT, permitting one contracting party to unilaterally set standards extraterritorially would weaken international trade principles. The Japanese stated that the U.S. challenge to Japan's safety and inspection system inevitably rendered the entire U.S. vehicle inspection and repair system and the U.S. after-market open to the scrutiny of other countries. And the USTR should have considered the effects if these countries decided to follow the U.S. lead and unilaterally judged whether the U.S. system was discriminatory or anti-competitive, and retaliated based on unilateral determination.

JAMA argued that the U.S. trade sanctions based on the Japanese inspection and repair system could not be justified on the basis of an arbitrary and unproven claim that it was not grounded in safety. Thus, Japanese considered the sanctions to be a disguised punishment of JAMA members and the Government of Japan for not agreeing to U.S. demands to

establish new so-called "voluntary plans" for purchasing U.S.-made parts at levels that meet U.S. Government expectations. They objected to using the market shares of U.S. auto manufacturers in Canada and Mexico in determining their share in the Japanese market, because Canada and Mexico were members of NAFTA.

Further, Japanese stated that the proposed duties violated the friendship, commerce and navigation treaty between the United States and Japan. They saw it as highly unusual for one nation to impose previously unannounced trade restrictions on another nation without at least permitting goods already ordered from production and "on the water" to be entered into the United States free of restrictions. At that time Japanese auto companies were "locked in" their production schedules months before. It was, therefore, wholly inequitable and unjustified to raise duty rates on vehicles ordered and produced long before there was any notice of the duty increase. This was a violation of the provisions of the U.S.-Japan Treaty of Friendship, Commerce and Navigation, which required at least 30 days' notice of tariff changes or exemption of goods in transit. Paragraph 1 of article 15 of the treaty provided:

As a general practice, new administrative requirements or restrictions affecting imports, with the exception of those imposed on sanitary

grounds or for reasons of public safety, shall not go into effect before the expiration of 30 days after publication, or alternatively, shall not apply to products en rout at time of publication [11].

JAMA stated that according to the terms of the friendship treaty, the punitive duties could become effective as of June 17, 1995 (30 days after the May 18, 1995 publication of notice in the Federal Register) or alternatively the duties could not be applied to products which were en route as of May 18, 1995. The USTR decision to impose punitive tariffs as of May 20, 1995, only two days after publication of its determination, violated Article 15 of the treaty.

In conclusion, JAMA argued that procedurally, legally, and substantively, USTR's proposal to place punitive tariffs of \$5.9 billion in auto exports based on a few sentences of unspecified claims of regulatory practices was simply unjustifiable, arbitrary and capricious.

In his testimony in Congress on June 8, 1995, Lee Kadrich, Senior Director of Government Affairs and Trade, stated that American firms still had less than two percent of Japan's \$107 billion auto parts market, and competitive non-Japanese owned U.S. parts makers supplied less than one-third of the \$20 billion in parts sourced by Japanese transplant assemblers in the United States. Japan's closed

auto parts markets had placed increasing strains on the U.S.-Japan relationship, as U.S. cumulative auto parts trade deficit increased to \$100 billion between 1980 and 1995. According to Mr. Kadrach, in 1994 the U.S. firms would have posted a \$5 billion global parts trade surplus if the \$12 billion U.S.-Japan trade deficit had not "dragged United States deep into the red"[12].

In connection to the threatened retaliation of the U.S. government against Japan, William A. Niskanen, chairman of CATO Institute, testified in Congress on June 13 to the Subcommittee on East Asia and Pacific Affairs of the Senate Foreign Relations Committee. In his testimony he said:

Americans should be offended to know that our government has demanded on the Japanese, specifically that the Government of Japan promote the sale of foreign autos and parts in Japan and the purchase of auto parts from American owned companies in the United States. Americans would be properly outraged if another government made similar demands on our government [13].

According to Niskanen's evaluations the sanctions on Japan would have been a lose-lose game. The U.S. consumers would have had to pay about \$6 billion more for the same volume of Japanese cars subject to the punitive tariff. The Japanese auto manufacturers would have lost to the extent that the reduction of U.S. sales of the cars subject to the punitive tariff could not be offset by an increase in sales

of these cars in other markets or of other cars in the U.S. market. The biggest losers would have been the U.S. dealers and their 80,000 employees.

At his testimony Niskanen also said:

The U.S. position in the auto trade threatens our broader relations with Japan. The U.S. demands for quantitative trade commitments are demands for managed trade, not fair trade. The U.S. demands for changes in the Japanese domestic regulations and business practices that are not violations of existing agreements undermine our high ground on other issues, such as the airline route dispute, where there is clear violation of a prior agreement. Treating the Japanese negotiators as officials of an occupied nation reduces the prospects of their cooperation on other issues where we will want or need their support. More important, the pending sanctions undermine the rule of the law in international trade. In the auto trade dispute, our government has not charged the Japanese with any specific violations of international trade agreements; otherwise a case could have been brought before the GATT dispute settlement process years ago [13].

In Niskanen's opinion, complete acceptance on the part of Japanese of U.S. demands would have had no significant effect on the bilateral trade deficit, which was a consequence of macroeconomic conditions.

The trade war was avoided in the last moment. On June 28, 1995, the United States and Japan negotiated an agreement, which, however, did not contain mandatory targets. After the agreement was signed, the USTR issued estimates that it would lead to vast increases in the

purchases and improving of access to Japanese market: \$6.75 billion in increased sales of U.S. parts to the Japanese transplants by 1998; \$2.25 billion in increased parts sales to Japan; and 200 new American car dealerships in Japan by the end of 1996, increasing to 1,000 by the end of the decade.

However, Minister Hashimoto announced that the Government of Japan had nothing to do with these numbers. He argued that they were a compilation of business plans announced independently by a group of automobile companies. According to the official bulletin of the two governments these plans were not commitments, but business forecasts and intentions of the companies and that changes in market conditions might affect the fulfillment of these plans.

With regard to the increasing of the foreign dealerships, the Japanese government merely agreed to send letters affirming the freedom of companies to establish multiple-brand dealerships. Japanese companies agreed to appoint a contact person to facilitate joint dealerships.

As to the imported auto parts check rules, the Japanese government agreed to ease the regulations for independent auto repair shops that compete with dealer shops and to expand the list of parts that did not require strict certification.

Some members of Congress were not satisfied by the U.S.-Japan agreement. On June 30, 1995, Senator Dole, while expressing disappointment, said that the agreement did very little to address the continuing problem of market access in Japan. In his opinion, after the agreement was in place, Japan would remain the most closed major industrial economy in the world, because the restrictive business practices that effectively blocked the U.S. companies from penetrating the Japanese market were not addressed.

With regard to the bilateral trade deficit used by the United States as an argument for pressing Japan, Nobuya Noguchi, president of Japan External Trade Organization, New York, said:

Even if auto issues are resolved, the trade imbalance between Japan and the United States will not be corrected for some time to come.

At present, 60% of the trade imbalance is accounted for by the auto trade, but the auto imbalance is not the cause of the U.S. trade deficit with Japan. Even if Japan accepted all the U.S. demands now, the trade imbalance between our countries would not change much in the next several years. This is because the trade balance is determined by the macroeconomic factors of savings and investment [14].

Some critics of the approach of the U.S. government to the dispute defined the agreement as a failure for the U.S. president and a victory for the American consumers [15]. They said that enforceable trade target quotas were



inconsistent with the free trade and that demands for quotas undermined U.S. prestige in the world trading community, and created conditions for isolation of the United States from their allies. On the other side, forcing the Japanese government to become a bigger player in Japan's private sector would not have reduced the influence of Japan's bureaucrats in making economic decisions in the private sector.

As to the results of the agreement, in his report on trade expansion priorities from October 1, 1996, USTR said that the agreement had addressed the full range of barriers to market access regarding the sales of autos and auto parts in Japan. Sales of U.S.-made Big Three vehicles in Japan had increased 40 percent in the first half of 1996, and Japanese purchases of U.S. auto parts were rising steadily.

In the report on trade expansion priorities from October 1, 1997, USTR stated that during the first six months of 1997, sales of the U.S.-made Big Three vehicles had declined 17 percent over 1996 levels. He also said that, in spite of the increase in the U.S. auto parts with 14 percent during the first six months of 1997, foreign access to the Japanese market remained limited. United States and Japan were to meet early in October 1997 to

discuss "concrete measures for improving market access in this important sector" [16].

The USTR said that he also identified serious problems in U.S. bilateral trade relations with Japan. The report pointed to the Japanese closed distribution system, not transparent regulations, discriminatory procurement practices and restrictive business practices. According to the deputy USTR, the United States was very concerned that the Japanese deregulation in auto practices was slowing down.

A week before the USTR issued his report the American auto makers accused Japan, along with South Korea, for unfair trade barriers. The American Automobile Manufacturers Association, which represents General Motors Corp., Ford Motor Co. and Chrysler Corp., complained that Japan had failed to live up to the 1995 market-opening agreement. U.S. auto firms said that the weak Japanese currency had boosted Japanese car sales into the United States and sharply reduced U.S. sales in Japan, with the result of increasing U.S. trade deficit with Japan.

### **C. FAST-TRACK AND SUPER 301**

In 1997, Congress did not pass fast-track negotiating authority demanded by President Clinton to conduct trade liberalization based on reciprocity. Some members of Congress again argued that the U.S. market was too open by comparison to other countries and that United States did not need further liberalization of its market. What the United States needed was to press the other countries to remove their unfair trade practices. The argument was mainly the increasing U.S. trade deficit.

On November 13, 1997, Representative Roemer, while opposing fast-track legislation with the argument of the big trade deficit, said:

Rather than expanding a bad trade policy like NAFTA, we should strengthen existing trade policies with tougher enforcement provisions like Super 301, which is used to force our trading partners to open their markets to American goods. So-called super 301 gives the President authority to challenge foreign barriers to our exports, and helps us fight unjustifiable and unreasonable foreign trade practices. The Federal Maritime Commission recently invoked Super 301 to impose \$100,000 entry fee sanctions on each ship entering a United States port from Japan, the second largest supplier of United States imports. These sanctions were promptly delivered in response to Japan's failure to address anti-competitive maritime practices. This needs to be used more often.

...We must establish the rules of fair trade, and those must give priority to more vigorous

enforcement of Super 301 provisions and penalties against countries, which practice unfair trade [17].

In conclusion he said that fast-track legislation did not go far enough to encourage fair trade, but it did open U.S. markets.

In 1998, the U.S. again had huge bilateral trade deficits with some countries. The Asian economic crisis spurred the U.S. imports leading to further increasing of protectionist sentiments within Congress. In order to appease the calls for protection of some industries, especially steel industry, the U.S. government resorted to Super 301. In 1999, President Clinton re-instituted Super 301, which had expired in 1997. Some observers argued that renewal of this provision would help the President demonstrate to Congress that his administration intended to stand up for U.S. interests. And that this might improve his chances for winning approval for fast-track negotiating authority.

Japan was supposed again to be one of the main targets of Super 301. Its bilateral surplus with the United States for 1998 rose to \$58.3 billion. Deputy U.S. Trade Representative Richard Fisher said that the U.S.-Japan trade imbalance was not tolerable and that the United States was interested in having the numbers reversed [18]. However,

the super 301 again inspired reaction on the part of the Japanese. In January 1999, before the United States renewed the Super 301, the vice Minister of the Japan's Ministry of Trade and Industry said:

If the United States moves in contradiction to WTO rules, we will raise the issue with the WTO, [19].

Japan's import of autos and steel had sharply increased and this gave ground for arguments on the part of members of Congress for further exercising pressure on Japan for being unfair trader. And Japan was again included in the list of the USTR for having unfair trading practices. The Administration attached top priority to opening Japan's markets to U.S. goods and services stressing the need of implementation of fiscal stimulus and reform of Japan's financial sector. United States insisted on increasing of the U.S. exports of agricultural products to Japan and compliance on the part of Japan with the agreements on insurance, autos and auto parts, glass, and government procurement including computers and construction.

In its comments from April 4, 1999, on the U.S. Trade Representative's NTE report, the Japan's government argued that in many parts of the report the U.S. argument was marked by one-sided view and misinterpretations of the

facts. Japanese expressed disappointment that such a report was published. In the comments it was said:

Regarding the word "press" used in several parts of the report, one-sided expression such as one country pressing the other is not appropriate since every country is on equal footing with each other. The NTE report points out in a number of contexts that the share foreign-made products occupy in Japan's market remains low, and draws from this a conclusion that there are barriers hindering access to Japan's market. In reality, market share is determined by a wide variety of factors, particularly demand structures and the effort suppliers make to market their products; adopting results-oriented approach is not consistent with international rule based on free trade. ...The Government of Japan has a concern over the U.S. Government's having officially re-instituted Super 301... thereby strengthening the procedure for imposing unilateral measures [20].

In its comments on the specific issues raised in the NTE, the Japanese Government argued that the necessary measures were undertaken and the provisions of the U.S.-Japan agreements were being implemented.

According to the Japan's farm minister, the invocation of the controversial Super 301 could damage the ties between Washington and Tokyo. In the opinion of the Japan's Minister of Agriculture, Forestry and Fisheries, the punitive super 301 provision goes against the spirit of the WTO.

However, the calls from Congress to further press Japan on unfair trade practices with the argument of the bilateral

trade deficit have continued. On May 4, 1999, Senator Hollings said in his statement:

With our trade deficit continuing to grow and with Japanese vehicle manufacturers continuing to increase exports to the United States, I rise to remind my colleagues that competitive U.S. companies continue to be thwarted in their effort to break down the walls of "keiretsu" relationships built up over decades in Japan [21].

#### IV. THE ARGUMENT OF TRADE DEFICIT

On May 10, 1989, two weeks before the USTR announced Japan, Brazil and India as countries with priority practices under Super 301, Representative Crane said in his statement in Congress, that in spite of the problems with the Omnibus Trade and Competitiveness Act of 1988, the Super 301 mechanism was potentially the most dangerous. He argued that for the United States to demand that other countries remove their trade barriers when United States refused to remove its own was truly a recipe for disaster. Mr. Crane saw the use of Super 301 as an attempt to force the U.S. trading partners to help it cure its deficit problem, when in fact U.S. irresponsible overspending was the real cause of U.S. fiscal dilemma. He also said:

More than any other single provision of the 1988 Omnibus Trade and Competitiveness Act, the Super 301 amendment symbolizes the perverse wrong-headedness of the trade Act. It highlights the persistent refusal of Congress to admit that our trade problems and deficit stem from internal macroeconomic failures and the emergence of new economic competitors, not from the unfair trade practices of our rivals [22].



The result of the U.S. actions under super 301 since 1989 do not seem to have been successful in resolving the issues of bilateral trade deficit. And, from economic point of view, this is not surprising. Blaming bilateral deficits exclusively on differences in trade policy to some extent contradicts the movement of investment flows.

According to some analysts, the main reason that Japan's trade surplus with the United States increased sharply in the 1980s was that the Japanese government lifted many of its capital controls with the passage of the Foreign Exchange and Foreign Trade Control Law in December 1980 [23]. That allowed Japanese savings to flow in the United States, attracted by the more favorable rate of return.

In spite of the use by the politicians of the trade deficit as an argument for attacking Japan under super-301 provision, the trade deficit is not determined by the microeconomics of trade policy. It is a reflection of underlying macroeconomic factors, specifically investment flows. And these flows are determined by the national rates of savings and investment. Trade policy can only slightly affect these flows.

According to the balance-of-payments account, the value of what a nation gives to the rest of the world will be matched by the value of what it receives. More specifically the balance-of-payments account provides the two sides of one equation: the current account and the capital account.

Current account represents the flow of goods, services, investment income, and uncompensated transfers such as foreign aid and remittances across borders by private citizens.

Capital account represents the buying and selling of investment assets such as real estate, stocks, bonds, and government securities.

According to the balance-of-payments equation, if a country is buying more goods and services from the rest of the world than it is selling, the country must also be selling more assets to the rest of the world than it is buying.

The balance between the current account and the capital account means a direct connection between the trade balance on the one hand and the savings and investment balance on the other:

$$\text{Savings} - \text{Investment} = \text{Exports} - \text{Imports}$$

Therefore, a nation that saves more than it invests domestically, such as Japan, will export its excess savings in the form of net foreign investment. Therefore it will run a capital account deficit. The money, sent abroad as investment, will return to the country to purchase exports in excess of what the country imports, creating a corresponding surplus. A nation that invests more than it saves - the United States, for example - must import capital from abroad. Therefore, it will run a capital account surplus. And the imported capital allows the U.S. citizens to consume more goods and services than they produce, importing the difference through a trade deficit.

The exchange rate serves the role of connection between the capital and current accounts. As more net investment flows into the United States, the demand for dollars, which are needed for buying U.S. assets, rises. As the dollar becomes stronger relative to the other currencies, U.S. goods and services become more expensive to foreign consumers, thus reducing demand, while imports become relatively cheaper to Americans. Falling exports and rising imports adjust the trade balance until it matches the net flow of capital. As a result, foreign investors will outbid

foreign consumers for limited U.S. dollars until the investors satisfy their demand for U.S. assets.

The link between investment flows, balance of trade and the exchange rate means that opening of markets cannot be used as a tool for decreasing a bilateral trade deficit. If Japan, for example, opened its markets further, as U.S. trade negotiators have been insisting for years, that would lead to a reduction in its overall trade surplus only for some time, as imports rose. But as they did so the Japanese currency would decline in value relative to others. This would make Japan's exports cheaper in terms of other currencies, so that its exports would increase, eventually offsetting any increase in its imports and restoring the trade balance to its original level.

So the trade balance is not fundamentally affected by the trade policy - that is, whether and to what extent the United States and other countries practice "unfair trade." Trade deficit is a consequence of macroeconomic activity. If a country produces domestically more than it consumes, it must by definition run a positive trade balance. And, if a nation consumes more than it produces, then it must be running a negative trade balance.

If a country has a positive current account, then it is spending less than its total income and lending the difference to the rest of the world. Conversely, running a current account deficit requires a nation to borrow from the rest of the world, or alternatively, to sell some of its domestically owned assets to foreigners.

The discrepancy between domestic levels of savings and investment is determined by the behavior of the government and the private sector (See Appendix A). If the U.S. government or the private sector do not have to borrow or if the net saving of one of them offsets the borrowing of the other, then the United States will not need to borrow abroad. And whether government needs to borrow depends on whether taxes cover spending. If taxes exceed government spending, the government is saving; if taxes fall short of spending, the government runs a deficit. By the same token, whether the private sector needs to borrow is determined by whether private investment exceeds private saving. If businesses and households save less than they invest, they must borrow from the government surplus or from foreigners to finance the excess.

Thus, a nation's balance on its current account will equal the sum of the net government borrowing and private

sector borrowing, i.e. the difference between the national saving and investment. Countries that save through the government and the private more than they invest domestically, as does Japan, run current account surpluses. Countries that invest more than they save at home, as the United States has done for more than two decades, must run current account deficits.

Also, the United States offers high and safe returns to investors and this additionally attracts foreign capital. And primarily for this reason U.S. runs trade deficit.

In the late 1980s and early 1990s, the total U.S. government borrowing was rising [24]. At the same time the private sector had become net saver and the U.S. current deficit decreased. Since 1992, the government deficit and its borrowing have decreased, but the current account deficit had risen again. This has been the result of a faster growth in investment than saving in the private sector.

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## V. CONCLUSION

Based on the cases considered above, the conclusion can be drawn that the Super 301 provision was not very successful in solving the problem with the bilateral trade deficit with Japan. Neither did it help open the Japanese market to the extent expected. The fact that the complaints of the U.S. auto-manufacturers continued in the years after an agreement was reached shows that the threat of retaliation only leads to excessive tensions between United States and Japan.

The Super 301 proves to be unnecessarily inflammatory, and adds little or no additional negotiating leverage. Foreign countries attacked under Super 301 in most of the cases refused to get into dialogue on trade issues in the context of this amendment of section 301. Only minor concessions were obtained from the targeted countries. The countries labeled as unfair traders usually reacted with resentment and blamed the United States for acting in contrary to the principles of international trade.

The failure of Super 301 to achieve what it was supposed to accomplish is an indication of the limitations of bilateral trade negotiations based on unilateral demands. The resort to this measure is potentially counterproductive.



The threat of retaliation against Japan in 1995 might have made the Japanese unwilling in 1996 to agree to continue their voluntary export restraints concerning semiconductors.

When the Super 301 was passed the dominating perceptions in Congress were that the GATT rules were insufficient to ensure fair trade. However, the establishment of the WTO in 1995 substantially changed the political and economic calculus of retaliation for the United States and its trading partners.

For issues falling within the WTO's broad range, the credibility and political weight of retaliatory threat is enhanced. On the other side, the new dispute settlement procedures make the United States a more vulnerable and a more likely target of retaliation if it refuses to play by the new rules it sought. Moreover, if the United States continues to use trade threats in ways perceived by targeted countries as violation of GATT's norms or procedures, the costs in terms of integrity of the multilateral system are high. In the Uruguay Round, the United States had insisted on establishing of new dispute settlement procedures. The new rules circumscribe the unilateral retaliatory actions against unfair foreign practices in two ways. First they require the nations, members of WTO, to use the procedures of the multilateral dispute system before retaliating.

Second, they forbid retaliation by increasing tariffs bound by WTO. Such an action will violate the multilateral unconditional most-favored-nation rule.

Under Super 301, if some U.S. trading partners particularly the larger ones refuse to negotiate, the United States must either retaliate, or lose credibility. And either outcome carries potentially large economic and political costs. While systemic and structural barriers are a legitimate problem for U.S. exporters in some cases, forcing the president to address them by designating countries as unfair traders does not seem to be an effective solution.

The highly heated debates and publicized threats of retaliation inspire resentment and create conditions for failure in advance. The lobbies in the targeted countries press their governments not to yield to U.S. demands.

Resort to Super 301 potentially could also lead to erosion of U.S. leadership and credibility in multilateral and regional trade negotiations. Super 301 unnecessarily irritates U.S. trading partners, who associate it with the worst of the U.S. unilateralism: that is the labeling of countries as unfair traders and of specific practices as unreasonable when there is no violation of rules or agreements. Having agreed to significant reform of the GATT

dispute settlement process other countries resent renewed use of Super 301 that violates U.S. GATT obligations. It is difficult for U.S. trading partners to accept U.S. leadership in negotiating further reciprocal liberalization in the WTO or in regional forums if U.S. negotiators continue to make demands for unilateral liberalization backed by the threat of Super 301.

Today, due to the Asian crisis, U.S. domestic appeals for protection are very strong. And to avoid imposing of restrictions on imports that might appear to be inconsistent with WTO rules, the Administration resorts to Super 301 in order to divert the attention to the export opportunities. Getting tough on the "unfair" foreign practices could possibly help counterbalance the growing protectionism. However, the use of Super 301 in the future could produce the opposite of what is expected. There is a tendency for achieving access to foreign markets not through multilateral but bilateral trade negotiations. The use of Super 301 provision tends to reduce the incentive for U.S. exporters to lobby for multilateral trade agreements, because new markets are being opened through other means. As a result, the political pressure against the open multilateral trading system may intensify. And by circumventing the multilateral

trade negotiations, the U.S. actions under super 301 could weaken the WTO principles.

Another problem with the Super 301 is that for the time a country is investigated the possible trade contracts between American companies and companies from the targeted country may be put at risk. Mutually profitable deals may be missed, and the prospects for further business relations, weakened. The targeted country's businesses may divert their activity away from the United States and towards other partners. This way, American businesses may suffer losses. Although USTR has to impose retaliation in a way that is equal to the alleged harm caused by foreign countries' practices, the retaliation brings costs for the American consumers and some producers using the restricted imports. Only the import-competing producers would be benefited. But nonetheless there would be a dead-weight lost for the United States. In addition, the retaliation is associated with domestic income redistribution, thus creating conditions for costly lobbying and interest-group politics.

Pressing the Administration to target foreign countries can interfere with other President's foreign policy goals. Congress empowered USTR for investigations and determinations in order to for the retaliation to be protected from the President's policy priorities. But this

complicates the Administration's interaction with the targeted countries's governments on other important issues.

When a foreign government agrees to concessions under Super 301 it risks invoking popular resentment. Thus, the positions of target country's government may be jeopardized. And this may make this country's government resent negotiations at all under threat in order to avoid humiliation in the eyes of its people, thereby worsening the relationship with the United States.

By acting under Super 301 United States often requires market shares by the governments of other countries. This seems to be in contrast to the principles of free market. The enactment and applying of Super 301 has represented a move toward managed trade. Government intervention and market-share goals are substituted for market forces and multilateral rules. Being pressed under Super 301 the target country's government may increase its use of price controls, import quotas, exchange controls, administrative guidance, and other restrictions, which later become very hard to get rid of because they are defended by local lobbyists.

## APPENDIX A

The macroeconomic determinants of a nation's current account can be generated from the national income accounting identities. The gross national product (GNP) of a country is defined as following:

$$\text{GNP} = C + I + G + X - M,$$

where C is private domestic consumption, I is private domestic investment, G is government spending, X is exports, and M is imports. This can be rewritten as:

$$\text{CA} = (S - I) + (T - G),$$

where CA is the balance on the current account, T is tax revenue and S is private domestic savings. Thus, any surplus (deficit) in the current account must be a consequence of an excess (shortfall) of net domestic savings, either private (S - I), and /or public savings (T - G).

Any a deficiency in net savings must be compensated by importing foreign savings. If a country has a negative current account balance, it is a net debtor.

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